



Legislative Research Council

RETIREMENT LAWS COMMITTEE MINUTES

**First Meeting
2003 Interim
June 18, 2003**

**Ramkota Inn
Pierre, South Dakota**

The first meeting of the 2003 interim of the Legislature's Retirement Laws Committee was called to order by Chair Representative Matthew Michels at 9:15 a.m., June 18, 2003, in the Lake Francis Case Room of the Ramkota Inn, Pierre, South Dakota. The committee met jointly with the Board of Trustees of the South Dakota Retirement System.

A quorum was determined with the following members answering the roll call: Senators Kenneth D. Albers, William Earley, Clarence Kooistra, Dan Sutton, and Paul Symens; and Representatives Burt Elliott, Matthew Michels, Mel Olson, Tim Rounds, and Lou Sebert.

Annie M. Mertz, Senior Fiscal Analyst, and Kris Schneider, Legislative Secretary, staffed the meeting.

(**NOTE:** For sake of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents are on file with the Master Minutes.)

Investment Performance Update

Mr. Steve Myers, State Investment Officer, reported that at the end of September 2002, the plan had had its single worst quarter with a negative 10.3% return. The good news was that the plan had a positive return of 7.12% as of June 16, 2003; however, it is not the end of the fiscal year yet so the number may change. Mr. Myers stated that the plan had out performed private plans by 2.7%.

Membership and Experience Report

Mr. Wade Hubbard, Acting Administrator, South Dakota Retirement System (SDRS), distributed copies of an overhead presentation titled "SDRS Membership and Experience Report Fiscal Years 2002 and 2003" (Document #1). Mr. Hubbard reviewed the report and stated that SDRS currently has 63,559 members from 461 member units with three more units coming on board July 1, 2003. In response to Representative Olson's question, if teachers from a reservation run school are eligible to participate, Mr. Hubbard explained that when an organization makes a request to join the plan, SDRS refers to the Internal Revenue Service (IRS) laws to ensure the organization meets federal requirements. In the case of tribal run schools, because of sovereignty issues, they would not qualify under the IRS laws. In response to Senator Earley's question on how the State Bar would qualify, **Justice**

Steven Zinter, SDRS Board of Trustees, replied that they are a creature of statute and are regulated by the South Dakota Supreme Court. In response to Senator Earley's question, if the system knows how many members are taking early retirement, **Mr. Paul Schrader**, Consulting Actuary, Buck Consultants, responded that the average retirement age for Class A members is 61 and that number is going down. **Ms. Pam Roberts**, SDRS Board of Trustees, asked that staff provide a report that shows the breakdown for early retirees by employer. Mr. Hubbard projected that the plan will pay out approximately \$180 million in benefits for this fiscal year, of which ninety percent stays in South Dakota. He stated that the number of retirement estimates was up 32.2%, number of purchase estimates was up 25.4%, and the number of refunds was down 7.9%. **Mr. Rob Wylie**, SDRS staff, stated there are currently four hundred twenty-eight retirees/rehires. Representative Michels requested a breakdown over the last three years of the retirees/rehires broken down by employer entities. Mr. Hubbard stated that the system is operating at 55.43% of what it could be as allowed by statute; and that compared to other systems, current staffing is at approximately 55%.

Funded Status

Mr. Paul Schrader distributed copies of an overhead presentation titled "SDRS Funded Status Review" (Document #2). Mr. Schrader stated that as of June 30, 2002, SDRS' 101% market value funded ratio ranked third out of forty-four in a study of comparable state retirement systems. He stated that the reserve financed the shortfall experienced in the previous two years. He suggested that the board continue to look long term and deal with the worst-case scenario. **Mr. Myers** stated that as of today, the fund was between \$118 and \$210 million, which would be about a 7% investment return. Mr. Schrader stated that if the system used 5% instead of 8% for the assumption, the market value funded ratio at the end of a five-year period would be 88% instead of 101%. He stated that the issues before the board were: 1) short-fall--right now there is not one; 2) ability to earn over 8% after June 30, 2003, and make up the short-fall, if any; and 3) ability to earn 8% over the short term. He concluded that SDRS remains well funded; that as of June 30, 2003, SDRS should have a small cushion, or a small short-fall; that the reserve has protected the system during a sustained bear market; and that the reserve is now depleted.

Actuarial Assumptions

Mr. Paul Schrader distributed copies of an overhead presentation titled "SDRS Actuarial Assumptions" (Document #3). He reviewed the actuarial assumptions, emphasizing that they should be reviewed collectively, not separately. He stated that the investment return assumption of 8% was last modified in 1999 and is based on a real annual return (above inflation) of 3.5% and a rate of inflation of 4.5%. He stated that over the long term, the past 29 years, the rate of inflation has been 5%. He noted that the cost of living allowance (COLA) is an automatic annual increase of 3.1% regardless of the inflation rate. In response to a question regarding how social security bases their COLA, Mr. Schrader stated that social security uses an index to compute the COLA. He explained that if the investment return of 7% is earned versus the 8% assumption, the result is a loss of: \$50M over one year, \$300M over five years, \$1B plus over the life of the system, less the impact of inflation on pay increases. In conclusion, Mr. Schrader stated that the board needs to think long-term,

set actuarial assumptions accordingly, plan for the unexpected--including favorable and unfavorable experience, and be consistent. The board needs to prepare for what would have to be done if the fund underperforms.

Review of SDCL 3-12-122

Mr. Paul Schrader distributed copies of an overhead presentation titled "Proposed Changes to Section 3-12-122" (Document #4). Mr. Schrader explained that the proposed revisions will: 1) require early warning and a formal report if funding standards are not met at any actuarial valuation; 2) require benefit and/or contribution recommendations if funding standards are not met for three consecutive actuarial valuations; and 3) provide for new funding standards. The proposed new funding standards are: 1) 30-year or less funding period (currently 20-year); 2) 80% or better funded ratio based on less of: market value of assets or actuarial value of assets (adding market value); and 3) market value of assets must be at least 90% of actuarial value of assets. **Mr. Don Zeller**, SDRS Board of Trustees, requested that the term "actuarial valuation" be changed to "year."

Review of Benefit Structure and Actuarial Assumptions

Mr. Paul Schrader distributed copies of an overhead presentation titled "SDRS Effect of Benefit and Actuarial Assumption Changes" (Document #5). Mr. Schrader stated that the board needs to look at problem areas: 1) to determine the effect on calculation of future SDRS liabilities of: a) benefit changes; b) actuarial assumption changes; and c) administration changes; and 2) emphasis on benefit changes that: a) have higher than expected cost; b) have potential for abuse; and c) exceed competitive levels. Benefit areas that he suggested the board review are: 1) remove the 5% minimum for interest credit on contributions; 2) eliminate PRO; 3) eliminate termination pay in final average salary; 4) modify the retire/rehire provisions to cost neutral basis; 5) make credited service purchase cost neutral; 6) eliminate subsidy to optional spouse benefit; 7) modify credited service calculation to credit completed months; 8) reduce future COLA; 9) change the benefit formula multiplier; and 10) reduce the disability benefits, death benefits while employed, and survivor benefits after retirement by 20%. Actuarial assumptions that he suggested the board review are: 1) lower investment return assumptions; 2) decrease inflation assumption in pay projections; 3) reduce expense factor; 4) modify PRO utilization assumptions; 5) increase retiree life expectancy by 10%; and 6) lower disability utilization by 20%. Mr. Schrader stated that the board needs to prioritize the changes that may need to be made and set up a timeline to review all of the actuarial assumptions.

Cost-Neutral Proposals

Mr. Paul Schrader distributed copies of an overhead presentation titled "SDRS Examples of Benefit Changes to Curb Higher Than Expected Costs and Reduce Potential for Abuse" (Document #6). Mr. Schrader reviewed the following proposed changes: 1) retire/rehire changes in response to objections to SB 16; 2) final average salary changes to eliminate the inclusion of accumulated sick leave or annual leave paid at retirement, eliminate advantage of changing payment contract period near retirement, base final average salary on quarters

prior to final quarter of employment, exclude bonuses from compensation definition, and tighten limits in SDCL 3-12-47(34); 3) credited service purchase rates changes to pay true cost; and 4) optional spouse benefit changes to cover the "bad experience."

Mr. Hubbard reported that staff has had several phone calls from out-of-state residents who have prior public service outside of South Dakota, who plan to move to South Dakota, work a year for a member unit, buy back their credited service, and then retire. Mr. Schrader stated that a large number of members are buying their credited service close to retirement and are paying about one-third of what it actually costs the system. Following a brief discussion of credited service purchases, Senator Earley suggested that no new groups be allowed to come into the system without the board reviewing them because of the impact to the system. Senator Albers stated that SDCL 3-12-67 defines who may come into the system.

Administrator Search

Ms. Sandy Zinter, SDRS Board of Trustees, reported that they received thirty-five applications for the administrator's position. The next step will be to review the applications for relevant education and experience, have them complete a written exam, and then the board will conduct interviews. They hope to have a new administrator hired no later than September 1.

Discussion

Chair Michels thanked the Board of Trustees for the opportunity to meet with them jointly and asked if the Retirement Laws Committee could meet jointly with the Board of Trustees at their winter meeting to receive an update on the system and discuss any possible upcoming legislation. **Mr. Elmer Brinkman**, Chair, SDRS Board of Trustees, stated that the Board of Trustees would be meeting on December 10, 2003, and that the committee was welcome to join them.

Adjournment

Representative Rounds moved, seconded by Senator Sutton, that the Committee be adjourned. The motion prevailed on a voice vote.

The committee adjourned at 1:00 p.m.



All Legislative Research Council committee minutes and agendas are available on the South Dakota Legislature's Homepage (<http://legis.state.sd.us>). Subscribe to receive electronic notification of meeting schedules and the availability of agendas and minutes at MyLRC (<http://legis.state.sd.us/mylrc/index.cfm>).